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**LEGISLATION ON LEGAL CERTAINTY OF
SECURITIES HOLDING AND DISPOSITIONS**

**Member States Working Group
Second Discussion Paper**
of the Services of the Directorate-General Internal Market and Services

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INTRODUCTION

1. The present document builds on an earlier discussion paper discussed at the first meeting of the Member States' Expert Group on 12 February 2010. It incorporates a number of relevant suggestions aiming at improving the text made at the occasion of that meeting and send in writing to the Commission Services.
2. As the general policy considerations remain unchanged, the explanatory text is not repeated in the present paper.
3. The text in track-changes highlights the amendments as against the first Discussion Paper. Major changes are accompanied by a short explanation in a footnote. Where an explanation could sensibly figure in any future recital, the text is for the time equally put in a footnote associated with the relevant provision.

TEXT FOR DISCUSSION

Definitions

For the purposes of this Directive, the following definitions shall apply:

- (a) 'securities' means financial instruments or financial assets, other than cash, as listed in Annex I Section C of Directive 2004/39/EC, which are capable of being credited to a securities account, ~~as listed in Annex I Section C of Directive 2004/39/EC~~;
- (b) 'securities account' means a [technical mechanism][balance] established under an agreement between an account provider and an account holder ~~establishing, amongst other, procedures~~ allowing for the evidencing of securities holdings of that account holder with that account provider;¹
- (c) 'account provider' means a person who,
 - maintains securities accounts for account holders and is authorised in accordance with Article 5 of Directive 2004/39/EC to provide services listed in Annex I Section A indent (9) of Directive 2004/39/EC or is a Central Securities Depository as defined in Article [...] of [EMIL] and, in either case, is acting in that capacity;

¹ The amendment shall align the definition with the common understanding that a securities account is more than an agreement. It helps dismantle linguistic uncertainties surrounding the word "maintain", as under the former definition of account, the account provider would "maintain an agreement".

- in relation to Articles X-Y [rules on holding and disposition],² if not subject to the law of a Member State, in the course of a business or other regular activity maintains securities accounts for others or both for others and for its own account and is acting in that capacity;
- (d) 'account holder' means a person for whom~~whose name~~ an account provider maintains a securities account, whether that person is acting for its own account or for others, including in the capacity of account provider;
- (e) 'ultimate account holder' means an account holder which is not acting in the capacity of account provider for another person;
- (f) 'legal holder' means, the shareholder, bondholder or holder of other of other financial instruments, as defined by the law under which the relevant securities are constituted;³
- (g) 'book-entry securities' means the legal position which is conferred upon an account holder in respect of securities standing to the credit of the account holder's securities account;
- (h) 'insolvency proceeding' means any winding up proceeding or reorganisation measure as defined in Article 2 (1)(j) and (k) of Directive 2002/47/EC;
- (i) 'insolvency administrator' means any person or body appointed by the administrative or judicial authorities whose task is to administer an insolvency proceeding;
- (j) 'securities of the same description' means securities issued by the same issuer and being of the same class of shares or stock; or in the case of securities other than shares or stock, being of the same currency and denomination and treated as forming part of the same issue;
- (k) 'securities settlement system' means a system as defined in Article 2(a) of Directive 98/26/EC for the processing of transfer orders referred to under the second indent of Article 2(i) of Directive 98/26/EC;
- (l) 'acquisition' means the receiving of book-entry securities or of a security interest or other limited interest therein;

² This shall clarify that the rules on processing of rights flowing from securities shall not have extraterritorial effect by putting duties on non-EU account providers.

³ Both definitions were moved from the Title on exercise of rights to the general part on definitions.

- (m) 'disposition' means
- to relinquish book-entry securities (disposal), in particular for the purpose of a sale,
 - to create security interests or other limited interests in a book-entry securities in favour of another person, or
 - to relinquish security interests or other limited interests in book-entry securities.
- (n) 'book entry' comprises the methods of crediting, debiting, earmarking and removal of an earmarking;
- (o) 'reversal' means that a book entry is undone by a converse act;
- (p) 'crediting' means the adding of book-entry securities to a securities account;
- (q) 'debiting' means the subtracting of book-entry securities from a securities account;
- (r) 'earmarking' means an entry in a securities account made in favour of a person, including the account provider, other than the account holder in relation to book-entry securities, which, under the account agreement, a control agreement, the rules of a securities settlement system or the applicable law, has either or both of the following effects:
- that the account provider is not permitted to comply with any instructions given by the account holder in relation to the book-entry securities as to which the entry is made without the consent of that person;
 - that the relevant intermediary is obliged to comply with any instructions given by that person in relation to the book-entry securities as to which the entry is made in such circumstances and as to such matters as may be provided by the account agreement, a control agreement or the rules of a securities settlement system, without any further consent of the account holder;
- (s) 'control agreement' means an agreement in relation to book-entry securities between an account holder, the account provider and another person or, if so provided by the applicable law, between an account holder and the account provider or between an account holder and another person of which the account provider receives notice, which includes either or both of the following provisions:
- that the account provider is not permitted to comply with any instructions given by the account holder in relation to the book-entry securities to which the agreement relates without the consent of that other person;

- that the account provider is obliged to comply with any instructions given by that other person in relation to the book-entry securities to which the agreement relates in such circumstances and as to such matters as may be provided by the agreement, without any further consent of the account holder;
- (t) 'attachment of book-entry securities of an account holder' means any judicial, administrative or other act or process to freeze, restrict or impound book-entry securities of that account holder in order to enforce or satisfy a judgment, award or other judicial, arbitral, administrative or other decision or in order to ensure the availability of such book-entry securities to enforce or satisfy any future judgement, award or decision;
- (u) 'central securities depository' means an account provider as defined in Article X(y) of [EMIL];
- (v) 'regulated market' means a system as defined in Article 2(14) of Directive 2004/39/EC;
- (w) 'certificated securities' refers to securities which are, following the law under which they are constituted, incorporated in or represented by a physical token;
- (x) 'dematerialised securities' refers to securities which are not certificated.

Shared functions

If a person other than the account provider is responsible for the performance of [certain, but not all,] functions of an account provider under this directive, references in [any] of the provisions of this directive to an account provider are to the person responsible for performing the function to which that provision applies.⁴

⁴ This provision was included to accommodate the existence of so-called account operators, which deal with the account provider's clients without being themselves an account provider (e.g. they don't maintain accounts different from those of the account provider. For instance, in a number of Scandinavian countries, the account provider for ultimate account holders is the CSD. Banks (and other regulated intermediaries) have a limited involvement; they act on the CSD's behalf and in some limited aspects on the accounts of the ultimate account holders by bringing, for instance, changes to these accounts. For those, or similar, cases, the intention is that those "account operators" will be subjected to the rules of the Directive to the extent that they concern those limited aspects. The square brackets indicate questions for discussion.

Book-entry securities

1. Member States shall ensure that book-entry securities confer upon the ultimate account holder at least the following rights:⁵

- (a) the right to exercise and receive the rights attached to the securities, ~~as far as the account holder is not acting in a capacity of account provider for a third person;~~
- (b) the right to effect a disposition under [the provision on acquisitions and dispositions];
- (c) the right to instruct the account provider to arrange for holding the securities with another account provider or otherwise than with an account provider[, as far as permitted under the applicable law legal framework, the terms of the securities and, to the extent permitted by the law of the Member State, the account agreement and the rules of a securities settlement system]⁶.

~~2. Member States shall ensure that book-entry securities confer upon account holders which act in the capacity of account provider the rights under paragraph 1 (b) and (c). In exercising these rights, the account provider must comply with the instructions of its account holder, as provided in [provision on instructions].~~

~~32.~~ In case of acquisition of a security interest or other limited interest in book-entry securities the Member States may restrict the above set of rights.

~~43.~~ Member States may attribute additional characteristics to book-entry securities and characterise the legal nature of book-entry securities as far as the characteristics or the legal nature do not contravene the rights cited in paragraph 1 or any provision of this Directive.

Acquisitions and dispositions

1. Member States shall provide for acquisitions and dispositions of book-entry securities and limited interests therein to be effected by ~~at least one of the following~~ methods of

~~(a) crediting an account and ;~~

debiting an account.⁷

⁵ The changes brought to this provision reflect the need to implement the concept of 'ultimate account holder' more broadly in the text (not exclusively in the section on exercise of rights), and to make it more apparent from the text that the set of rights differs depending on whether the account holder is an ultimate account holder or an account provider. The reference to the provision on instructions is to make immediately clear that the account provider is not free in its decision to dispose of securities.

⁶ The square brackets indicate that consideration is given at present to the question of whether a clarification along the lines of the text in square brackets is needed or whether it is not.

⁷ The split of former paragraph 1 into to separate paragraphs is to reflect the understanding that the methods of crediting and debiting are not optional.

2. Member States may in addition allow for acquisitions and dispositions being effected under one or more of the following methods:⁸;

~~(a)~~ earmarking book-entry securities in an account, or earmarking a securities account, and the;

~~(d)~~(a) removing of such earmarking;

~~(e)~~(b) concluding a control agreement;

~~(f)~~(c) concluding an agreement with and in favour of an account provider.

32. The ~~above~~ methods set out in paragraphs (1) and (2) shall prevail over any other method permitted by the law of a Member State.⁹

43. Member States may characterise the legal nature of dispositions over book-entry securities effected under the above methods as far as the legal nature does not contravene [the provisions on effectiveness, reversal and protection of acquirer].

54. Acquisitions and dispositions arising by mandatory operation of the law of a Member State are effective and have the legal attributes, in particular rank, attributed by that law.

Effectiveness of acquisitions and dispositions

1. Member States shall not require any steps further than those set out in [the provision on acquisitions and dispositions] paragraph 1 to render an acquisition or disposition effective between the account holder and the account provider and against third parties.

2. Effectiveness in the above sense does not determine whom an issuer has to recognise as legal holder of its securities.

3. [Member States may stipulate that the effectiveness can be made subject to a condition agreed upon between account holder and account provider. Credits to a securities account the effectiveness is subject to such condition must identifiable as such.¹⁰

4.] Member States may provide for reasons which trigger ineffectiveness of acquisitions and dispositions effected under a control agreement or an agreement with

⁸ Recital: Member States should be free to allow or disallow, within the scope of application of their law, the methods listed under (a)-(c). However, an insolvency proceeding in a Member State must recognise interests arising from a disposition effected under one of the methods (a)-(c) under the applicable law of another Member State. [remark: this result flows from principles of private international law and should therefore not be expressly stated in the text].

⁹ Recital: Member States law should be able to maintain other methods for acquisition and disposition; however, with a view to guaranteeing cross-border legal certainty, the harmonised set of methods must be given prevalence over any non-harmonised domestic method.

¹⁰ This requirement adds visibility to a conditional credit.

and in favour of the account provider and regulate the consequences of such ineffectiveness.

Effectiveness in insolvency

1. Acquisitions and dispositions that have become effective under [the previous provision] are equally effective against the insolvency administrator and creditors in any insolvency proceeding.
2. Paragraph 1 does not affect the application of any substantive or procedural rule of law applicable by virtue of an insolvency proceeding, such as any rule relating to:
 - (a) the ranking of categories of claims;
 - (b) the avoidance of a transaction as a preference or a transfer in fraud of creditors; or
 - (c) the enforcement of rights to property that is under the control or supervision of the insolvency administrator.

Reversal of acquisitions and dispositions

1. Member States shall ensure that book entries can be reversed under the following circumstances:

- (a) in the case of crediting with the consent of the account holder;
- (b) in the case of erroneous crediting without the consent of the account holder, subject to [the following provision];
- (c) in the case of debiting which was not authorised by the account holder, or a third person who has acquired an interest in the relevant book-entry securities under [the provision on acquisition and disposition];
- (d) in case of earmarking which was not authorised by the account holder, subject to [the provision on protection of acquirers against reversal];
- (e) in case of removal of an earmarking which was not authorised by the person in whose favour it was made.

2. Paragraph one is subject to any rule of a securities settlement system.

3. Member States shall specify the extent to which consent in the sense of paragraph 1(a) can be given in a general manner and any formal requirements for giving such consent.¹¹

¹¹ The second paragraph has been inserted for purposes of account holder protection.

Protection of acquirers against reversal

Member States shall ensure that

- (a) an account holder should be protected against reversal of a crediting;
- (b) a person in whose favour an earmarking has been made should be protected against reversal of this earmarking

unless it knew or ought to have known that the crediting or earmarking should not have been made.

Priority

1. Member States shall ensure that
 - (a) interests in the same book-entry securities which are acquired by earmarking rank amongst themselves in chronological order;
 - (b) interests in the same book-entry securities which are acquired by control agreement or an agreement with and in favour of the account provider rank amongst themselves in chronological order;
 - (c) interests in book-entry securities which are acquired by earmarking have priority over interests acquired in the same book-entry securities by means of a control agreement or an agreement with and in favour of the account provider.
2. Parties can deviate from the above rules by agreement. Such agreement cannot affect the rights of third parties.
3. Security interests or other limited interests created by mandatory operation of the law of a Member State should have the priority attributed by that law.

Integrity of the issue

1. Member States shall ensure that an account provider ~~has to maintain~~ holds¹², for each description of securities, a number of securities or book-entry securities that corresponds to the aggregate number of book-entry securities of the same description standing to the credit of ~~the~~ accounts that it maintains for its account holders and of its account holders or, if applicable, of accounts that it maintains for itself~~held for its own account~~.¹³

23. An account provider may comply with the obligation of paragraph 1 by

¹² This change brings this provision in line with the terminology of holding-maintaining as used in the remainder of the text.

¹³ No substantial change intended.

- (a) holding book-entry securities as an account holder with another account provider;
- (b) procuring that securities are held on the register of the issuer in the name, or for the account of the account holders;
- (c) holding securities as the registered holder on the register of the issuer;¹⁴
- ~~(e)~~(d) possession of certificates or other documents of title.

32. In the event that an insufficient number is ~~maintained~~held, Member States shall ensure that the account provider immediately applies either or both of the following mechanisms in order to re-establish the maintaining of a sufficient number:

- (a) the reversal of erroneous ~~credits~~bookings, subject to [the provision on protection of acquirers against reversal];
- (b) the provision of additional securities of the relevant description, to be held in accordance with paragraph 2.

The sharing of any cost entailed by the provision of additional securities pursuant subparagraph (b) can be subject to a contractual agreement between the account provider and those account holders holding securities of the relevant description at the time of the occurrence of the loss in non-segregated accounts only in cases where the account provider held securities of the relevant description with another account provider pursuant to Article 17(3) subparagraphs (a) and (b) of Directive 2006/73/EC.¹⁵

4. As long as an insufficient number is held and until measures under paragraph 3 are successfully applied, the credits of securities of the relevant description to the accounts of account holders are effective only up to the limit of the aggregate number of securities or book-entry securities held in accordance with paragraph 2, and the amount of book-entry securities of the relevant description remains reduced pro-rata in each securities account.¹⁶

Protection of account holders in case of insolvency of account provider

1. Member States shall ensure that in the event of insolvency of the account provider securities ~~or~~and book-entry securities held by the account provider for its account holders in compliance with [with paragraph 1 and 2 of the provision on integrity

¹⁴ This is to make clear that both methods (account holder *or* account provider in the issuer's register) are appropriate.

¹⁵ This new paragraph follows the opinion that in certain, limited, cases, the account provider should be in a position to pass on the cost of a buy-in measure to its account holders, especially where the latter have expressly required the securities being held with a specific (unsafe) sub-custodian. The MiFID Implementation Directive uses the same argument from a regulatory point of view.

¹⁶ This is a new concept to strengthen protection against the creation of excess securities. Even if quick curative measures (reversal, buy-in) are required, the law has to make sure that in the meantime, even if it is only a short period, no excess securities circulate in the system. The method is to keep the excess "ineffective" on a pro-rata basis, reducing the effective holdings of each account holder accordingly without reversing or debiting securities, until the situation is solved.

~~of the issue] are unavailable for distribution among or realisation for the benefit of creditors of the account provider, for its own account shall be attributed to its account holders, as far as the number of securities held by the account provider for its account holders is insufficient.~~

2. ~~Member States shall ensure that the law applicable in the insolvency of an account provider provides for a mechanism governing the distribution of the shortage in the event of an insufficient number of securities or book-entry securities in the sense of paragraph 1 [of the provision concerning the integrity of the issue] being held by an insolvent account provider.¹⁷ A remaining shortage of book entry securities on the accounts of the account holders of the insolvent account provider shall be shared amongst the account holders. The relevant rules of a securities settlement system can apply in accordance with the law that governs that system.~~

Instructions

1. An intermediary is neither bound nor entitled to give effect to any instructions in relation to book-entry securities of an account holder given by any person other than that account holder.

2. Paragraph 1 is subject to:

- (a) the provisions of any agreement between account holder and account provider;
- (b) the rights of any person (including the intermediary) who has acquired an interest in the relevant book-entry securities under [the provision on acquisition and disposition];
- (c) any judgement, award, order or decision of a court or other judicial or administrative authority of competent jurisdiction;
- (d) any applicable rule of the law of the Member State;
- (e) if the account provider is the operator of a securities settlement system, the rules of that system.

Attachment of book-entry securities

1. Member States shall ensure that creditors of an account holder may attach book-entry securities only at the level of the account provider of that account holder.

2. Creditors of an account provider may not attach securities credited to accounts opened in the name of that account provider with a second account provider, as far as these accounts are identified as containing securities belonging to the first account provider's customers. Where the law of a Member State provides for a presumption that

¹⁷ The changes to paragraphs 1 and 2 take account of the concern that the earlier version encroached upon policy choices regarding the distribution of assets in the insolvency of the account provider.

accounts opened by an account provider with a second account provider contain clients assets, the presumption applies.

*Determination of the applicable law*¹⁸

1. Member States shall ensure that any question with respect to any of the matters specified in paragraph 4 arising in relation to book-entry securities shall be governed by the law of the country where the relevant securities account is maintained by the account provider. Where an account provider ~~acts through has~~ branches located in Member States different from the headquarter's Member State, the account is maintained by the branch which handles the relationship with the account holder services the client in relation to the securities account, ~~otherwise by~~ the headquarter.¹⁹
2. An account provider in the sense of the first indent of [... EU regulated account provider] is responsible for communicating to the account holder the branch which services the account holder in writing. The communication itself does not alter the determination of the applicable law under paragraph 1.
3. The reference to the law of the country is a reference to its domestic law, disregarding any rule under which, in deciding the relevant question, reference should be made to the law of another country.
4. The matters referred to in paragraph 1 are:
 - (a) the legal nature of book-entry securities;

¹⁸ Draft recital in connection to this provision: "Since the conflict-of-laws rules contained in Directive 98/26/EC on settlement finality and Directive 2002/47/EC on financial collateral agreements are restricted in their personal and material scope and as the connecting factors used in both directives differ from each other, the question of a conflict-of-laws rule governing book-entry securities needs to be covered comprehensively. To this end, a single, uniform rule needs to be designed, encompassing the complete personal and material scope of the two aforementioned directives and the present directive. The connecting factor of the conflict-of-laws rule should be based on the factual criterion similar to the criterion used in the two directives, i.e. where a securities account is 'maintained'. However, more guidance is needed for proper interpretation of this criterion.. In this respect, regard has to be given to the reasonable perspective of the account holder, which expects that the law of the country is applicable where the branch is located by which it is serviced, taking into consideration through which branch the account was opened, which branch handles the commercial relationship with the account holder, and which branch administers payments or corporate actions relating to the securities credited to the securities account. However, the place of the location of supporting technology or of call or mailing centres shall be disregarded. In addition to additional clarification of the connecting factor, ex-ante legal certainty requires the account holder to expressly know which law governs its account. The account provider always knows where an account is maintained and serviced and shall communicate to the account holder the relevant location. However, this communication must not be able to alter the underlying, fact based analysis of where the account is actually maintained. The account provider shall be responsible for the correct fulfilment of this duty and the competent authority shall be in a position to intervene where the communication does not reflect the location where the account is actually serviced. There need to be a clarification so as to clearly include all securities booked to securities account, regardless the legal nature that national law attributes to them, in particular in cases where the legal nature of foreign securities booked to securities accounts is characterised as contractual".

¹⁹ The changes brought to paragraph 1 are for clarification purposes only. The term of "servicing" has been replaced by a more appropriate wording.

- (b) the legal nature and the requirements of an acquisition or disposition of book-entry securities as well as its effects between the parties and against third parties;
- (c) whether a disposition of book-entry securities extends to entitlements to dividends or other distributions, or redemption, sale or other proceeds;
- (d) the effectiveness of an acquisition or disposition and whether it can be invalidated, reversed or otherwise be undone;
- (e) whether a person's interest in book-entry securities extinguishes or has priority over another person's interest;
- (f) the duties, if any, of an account provider to a person other than the account holder who asserts in competition with the account holder or another person an interest in book-entry securities;
- (g) the requirements, if any, for the realisation of an interest in book-entry securities.

5. Paragraph 1 determines the applicable law regardless of the legal nature of the rights conferred upon the account holder upon crediting of book-entry securities to his securities account.

6. The Commission shall, in accordance with the procedure laid down in [...](#), adopt implementing measures specifying the formal requirements for any communication under paragraph 2.

Recognition of holding through securities accounts

1. Member States shall ensure that the ultimate account holder is able to receive and exercise the rights flowing from securities, regardless whether it is either itself identified by the applicable law as the legal holder of the securities, or its account provider or a third person is identified by the applicable law as the legal holder of the securities.

2. The ultimate account holder shall be able, in any case,

- (a) to receive and exercise the rights flowing from the securities itself, with or without facilitation by its account provider as provided in [\[the provision on facilitation\]](#), or
- (b) to have these rights received or exercised by its account provider or a third person under its instruction, as provided in [\[the provision on exercise\]](#).

3. Where an account holder is not subject to the law of a Member State its account provider must take appropriate measures to ensure the effective exercise of rights flowing from securities which the account holder might hold for others.

Facilitation of the exercise

1. Member States shall require that the account provider facilitates the receipt or exercise by the ultimate account holder of the rights flowing from the securities against

the issuer or a third party where the facilitation is necessary for the effective receipt or exercise or where it is requested by the ultimate account holder.

2. Such facilitation must at least consist in
 - (a) providing the ultimate account holder, regardless whether he is the legal holder of the securities or not, with a certificate confirming its holdings; or,
 - (b) arranging for the ultimate account holder being the representative of the legal holder with respect to the receipt or exercise of the relevant rights ("proxy"), where an account provider or a third person is the legal holder of securities, in which case Article 11 of Directive 2007/36/EC applies correspondingly.
3. The Commission shall, in accordance with the procedure laid down in [...](#), adopt measures specifying
 - (a) the extent to which the obligations following paragraphs 1 and 2 can be made subject to a contractual agreement between the ultimate account holder and its account provider as well as the formal requirements to be met by such agreement;
 - (b) in respect of point (a) of paragraph 2, the content of the certificate to be provided, establishing a standard form to be used throughout the Community for that purpose, and the conditions under which issuers shall recognise such certificate.

Exercise under instruction given by the ultimate account holder

1. Member States shall oblige account providers to receive and exercise rights flowing from securities
 - (a) where the ultimate account holder is unable to exercise the rights itself because the account provider or a third person is the legal holder of the securities. The receipt or exercise shall be conditional upon authorisation and instruction by the ultimate account holder.
 - (b) where an ultimate account holder is able to exercise itself the rights flowing from securities but does not want to do so, its account provider is obliged to exercise these rights upon its authorisation and instruction and in accordance with the contractually agreed level of services.
3. The Commission shall, in accordance with the procedure laid down in [...](#), adopt measures specifying
 - (a) the extent to which the obligation following paragraph 1(a) can be made subject to a contractual agreement between the ultimate account holder and its account provider as well as the formal requirements to be met by such agreement;

- (b) the formal requirements to be met by an agreement following paragraph 1(b) as far as it provides for general authorisation of the account provider to exercise the rights flowing from the securities.

Passing on information

1. Member States shall ensure that information with respect to securities received from an account provider by an account holder is passed on to the ultimate account holder as far as information

- (a) is necessary in order to exercise a right flowing from the securities which exists against the issuer; and

- (b) is directed to all legal holders of securities of that description.

2. Information with respect to securities received by an account provider from its account holder must be passed on to the issuer of the securities or, if applicable, the following account provider, as far as pieces of information are provided by the ultimate account holder in the course of the exercise of a right flowing from the securities which exist against the issuer.

3. The Commission shall,

- (a) in accordance with the procedure laid down in [...](#), adopt implementing measures in order to take account of technical developments in financial markets and to ensure the uniform application of paragraphs 1 and 2;

- (b) in accordance with the procedure laid down in [...](#), establish rules regarding the sharing of the cost entailed by complying with the obligations laid down in this [provision](#).

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